

FCC MAIL SECTION

Federal Communications Commission

FCC 98-1

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)	
)	CC Docket No. 97-237
Beehive Telephone Company, Inc.)	
Beehive Telephone, Inc. Nevada)	
)	Transmittal No. 6
Tariff F.C.C. No. 1)	

MEMORANDUM OPINION AND ORDER

Adopted: January 6, 1998

Released: January 6, 1998

By the Commission:

I. INTRODUCTION

1. By this Order, we conclude our investigation of Transmittal No. 6 filed on July 22, 1997 by Beehive Telephone Company, Inc. and Beehive Telephone, Inc. of Nevada (collectively "Beehive"). We find that Beehive has failed to justify its premium and non-premium interstate local switching access rates that are the subject of this investigation.¹ We, therefore, prescribe premium and non-premium local switching access rates for the period of August 6, 1997 through December 31, 1997, and direct Beehive to make refunds for this period of time, with interest.

II. BACKGROUND

2. Prior to 1994, Beehive charged the interstate local switching rates filed by the National Exchange Carrier Association (NECA) on behalf of incumbent local exchange carriers (LECs) that participate in NECA's traffic-sensitive access tariff. In 1994, Beehive filed a tariff pursuant to Section 61.39 of the Commission's rules,² which permits a qualifying LEC to file its own tariff for traffic sensitive interstate access charges under more simplified rules than those that apply to larger carriers.³ Specifically, under this section, smaller LECs base their initial traffic-sensitive interstate access rates on the carriers' cost of service and demand for the most recent twelve month period. An incumbent LEC filing under this section is required to revise its rates in odd-numbered years, based on the carrier's cost of service and

¹ See 47 C.F.R. §§ 69.105, 69.113.

² 47 C.F.R. § 61.39.

³ Small telephone companies are defined as those carriers with fewer than 50,000 access lines that also are part of NECA Subset 3, as defined by Section 69.602(a)(3) of the rules, 47 C.F.R. § 69.602(a)(3). See *Regulation of Small Telephone Companies*, CC Docket No. 86-467, Report and Order, 2 FCC Rcd 3811 (1987).

related demand for the historical period since its last annual filing.⁴

3. On July 3, 1997, Beehive filed a request for a waiver of the rule that requires it to file its biennial access tariffs with an effective date of July 1, 1997.⁵ The Competitive Pricing Division (Division) of the Common Carrier Bureau (Bureau) granted Beehive's waiver request and on July 22, 1997, Beehive filed its Transmittal No. 6, which proposed the rates, terms, and conditions under which Beehive would offer interstate access service for 1997-1999.⁶ In particular, Beehive proposed to increase its rate for premium interstate local switching from \$0.0348 per minute of use to \$0.04012 per minute of use and its rate for non-premium interstate local switching from \$0.015660 per minute of use to \$0.0180510 per minute of use. Transmittal No. 6 was scheduled to become effective on August 6, 1997.

4. On July 29, 1997, AT&T filed a petition urging the Commission to reject, or alternatively, to suspend and investigate Beehive Transmittal No. 6.⁷ AT&T alleged that Beehive's premium local switching rate was excessive because Beehive had overstated its revenue requirement.⁸ On August 4, 1997, Beehive filed an opposition.⁹

5. On August 5, 1997, in the *Beehive Tariff Suspension Order*, the Division concluded that Beehive's transmittal raised significant questions of lawfulness, including whether the proposed rates were unreasonably discriminatory in violation of Section 202(a) of the Communications Act of 1934, as amended (the Act); whether the proposed rates were unjust and unreasonable in violation of Section 201(b) of the Act; and whether Beehive had shown that its proposed traffic sensitive switched access rates were justified under the existing interstate access charge rules.¹⁰ The *Beehive Tariff Suspension Order* suspended all of the changes proposed in Transmittal No. 6 for one day, initiated an investigation, imposed

⁴ 47 C.F.R. § 61.39(b)(1)(ii). See *Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Report and Order, 8 FCC Rcd 4545, 4551 (1993). Section 69.3(f) requires small telephone companies to file access tariffs for a biennial period and a scheduled effective date of July 1 of any odd numbered year. 47 C.F.R. § 69.3(f).

⁵ Beehive Telephone Company, Inc., Request for Rule Waiver and Petition for Forbearance (filed, July 3, 1997).

⁶ Beehive Access Tariff FCC No. 1, Transmittal No. 6 (filed, July 22, 1997) (Transmittal No. 6). Beehive had filed the same tariff changes on July 14, 1997, with an improper notice period and withdrew the July 14 filing on July 16.

⁷ AT&T Petition to Suspend and Investigate and for Rejection of Beehive Transmittal No. 6, filed July 29, 1997 ("AT&T Petition").

⁸ *Id.* at 2-3.

⁹ Beehive Reply to AT&T's Petition to Suspend and Investigate and for Rejection, filed August 4, 1997 ("Beehive Reply").

¹⁰ *Beehive Telephone Company, Inc., Tariff F.C.C. No. 1, Transmittal No. 6*, CC Docket No. 97-237, Suspension Order, DA 97-1674 at paras. 6-8 (Com. Car. Bur., Comp. Pric. Div., rel. August 5, 1997) (*Beehive Tariff Suspension Order*).

an accounting order, and directed Beehive to file a tariff supplement reflecting the suspension.¹¹

6. On December 2, 1997, in the *Beehive Designation Order*, the Bureau designated for investigation the issue of whether Beehive's traffic sensitive local switching rate was based on its interstate cost of service for the period since its last annual filing and related demand for the same period, as required by Section 61.39(b) of our rules.¹² The Bureau directed Beehive to provide detailed cost data for calendar years 1994, 1995, and 1996 in the format set forth in Table 1 of FCC ARMIS Report 43-01. The Bureau also directed Beehive to provide the following: (1) all investment, expense, and revenue account balances that Beehive, as a Class B company, is required to maintain under Part 32 of the rules; (2) all of the interstate and intrastate amounts for each of the cost categories prescribed by Part 36 of the rules; (3) the amounts in each of the access charge categories in Part 69 of the rules; and (4) an explanation of the development of the revenue requirement for the local switching category for the local switching rate. The Bureau also required Beehive to provide an explanation supporting its calculation of demand and the dial equipment minutes (DEM) allocator, including separate interstate and state minutes of use (MOU) for each year, and an explanation and data supporting any changes in costs and demand from year to year.¹³

7. On December 15, 1997, Beehive filed its direct case in response to the *Beehive Designation Order*¹⁴ and filed supplemental information on December 16, 1997 and December 17, 1997.¹⁵ On December 22, 1997, AT&T Corp. (AT&T) filed an opposition to the direct case filed by Beehive.¹⁶ On December 29, 1997, Beehive filed its rebuttal.¹⁷

III. PLEADING SUMMARIES

A. Beehive Direct Case

8. In its direct case, Beehive submitted accounting data and additional information necessary

¹¹ *Id.* On August 5, 1997, Beehive filed Transmittal No. 7 reflecting the one day suspension of its rates.

¹² *Beehive Telephone Company, Inc., Tariff F.C.C. No. 1, Transmittal No. 6*, CC Docket No. 97-237, Order Designating Issues for Investigation, DA 97-2537 (Com. Car. Bur., Comp. Pric. Div., rel., Dec. 2, 1997) (*Beehive Designation Order*).

¹³ *Id.* at para. 7. On December 9, 1997, Beehive filed a motion requesting an extension of time to file its direct case in response to the *Beehive Designation Order*. The Division granted Beehive's motion. *Beehive Telephone Company, Inc., Tariff F.C.C. No. 1, Transmittal No. 6*, CC Docket No. 97-237, Order, DA 97-2597 (Com. Car. Bur., Comp. Pric. Div., rel. December 12, 1997).

¹⁴ Direct Case of Beehive in CC Docket No. 97 237, filed December 29, 1997 (Beehive Direct Case).

¹⁵ See Letter from Pamela Gaary, Beehive Telephone Company, to Magalie Roman Salas, Secretary, FCC, filed December 16, 1997 (Beehive December 16 Supplement); Beehive Supplement to Direct Case, filed December 17, 1997 (Beehive December 17 Supplement).

¹⁶ Opposition of AT&T Corp. to the Direct Case of Beehive (AT&T Opposition).

¹⁷ Reply of Beehive to AT&T Opposition in CC Docket No. 97-237, filed December 29, 1997 (Beehive Reply).

to calculate for calendar years 1994, 1995, and 1996 its revenue requirement for the following categories: total company, total interstate access, regulated interstate access, total common line, local switching, switched traffic sensitive, and special access.¹⁸ Beehive provided this information using Table 1 of FCC Armis Report 43-01. Beehive also provided the Part 32, Part 36, and Part 69 information requested by the Bureau in the *Beehive Designation Order*,¹⁹ and separate interstate and state MOU for each year.²⁰ Contrary to the requirements of the *Beehive Designation Order*, Beehive did not explain the manner in which it calculated its demand and DEM allocator for each year. Further, Beehive did not explain or provide data supporting the changes in its costs and demand from year to year that it submitted.

B. AT&T Opposition

9. In its opposition, AT&T contends that Beehive violated the Bureau's directive in the *Beehive Designation Order* by failing to provide an explanation supporting its calculation of demand and the DEM allocator and an explanation and data supporting any changes in costs and demand from year to year.²¹ AT&T states that, as it pointed out in its petition against Transmittal No. 6, Beehive's interstate local switching minutes of use drastically increased during 1995 and 1996 due to an arrangement with a chat line provider in its service territory. According to AT&T, "Beehive, since 1994, has shared its terminating access revenues with the chat line provider in return for the provider stimulating calling into Beehive's territory."²² AT&T asserts that, in light of this recent drastic upward adjustment in demand, Beehive's failure to explain how it calculated its demand and DEM allocator or the change in demand from year to year is a violation of the *Beehive Designation Order* and makes it impossible to verify the reasonableness of Beehive's rates. AT&T also argues that Beehive's failure to file any explanation or factors supporting its calculation of cost or demand complicates an analysis of what its local switching interstate access rate should be under a lawful rate of return.²³ In any case, AT&T asserts, the aggregate interstate rate of return Beehive reported for 1995 and 1996, on its face, is unlawful and, at a minimum, Beehive's local switching rate must be reduced so that it is targeted to earn a lawful rate of return.²⁴ AT&T concludes that Beehive's data are so deficient that the Commission can have no assurance that Beehive's access rate should not be even lower.²⁵

C. Beehive Rebuttal

10. In its rebuttal, Beehive states that the substantial increase in its interstate usage since the last quarter of 1994 resulted from an arrangement with Joy Enterprises, Inc., a chat line provider located

¹⁸ Beehive Direct Case, Appendix; Beehive December 16 Supplement.

¹⁹ Beehive Direct Case, Appendix; Beehive December 16 Supplement.

²⁰ Beehive December 17 Supplement.

²¹ AT&T Opposition at 2-3.

²² *Id.* at 6.

²³ *Id.* at 7.

²⁴ *Id.*

²⁵ *Id.* at 8.

within its service area,²⁶ and that the increased demand lead to a 70% decrease in its switched access rates in 1995.²⁷ Beehive indicates that its interstate local switching minutes increased from 3,563,877 minutes in 1994 to 25,465,362 minutes in 1995 and to 30,120,102 minutes in 1996.²⁸ Beehive maintains that the increases in its investment and expenses from 1994 to 1996 were primarily attributable to the purchase of fiber optic cable and the cost of additional switching equipment needed to handle the increase in interstate usage. Beehive also asserts, without further explanation, that the increased expenses included costs incurred in stimulating interstate usage.²⁹

11. In addition, Beehive states that it erred by failing to base its interstate local switching rate on its total cost of service and related demand for calendar years 1995 and 1996 as required by the Commission's rules.³⁰ After using cost and demand data for calendar years 1995 and 1996, Beehive calculates a premium local switching rate of \$0.032707.³¹

12. Beehive argues that, although it should have been charging AT&T the premium local switching rate of \$0.032707 since August 6, 1997, the Commission should not order refunds because Beehive has undercharged AT&T for local transport services.³² Beehive argues that its rates that became effective on January 1, 1998 are based on Beehive's cost of service and related demand for the years 1995 and 1996, and are targeted to produce an 11.25% rate of return.³³ Beehive claims that it was not aware of its high interstate rate of return figures and that it was neither negligent nor acting in bad faith.³⁴ Beehive notes that it had a total company (intrastate and interstate) annual rate of return for 1996 of 11%. Beehive also states that it has made unsuccessful attempts to resolve its rate dispute with AT&T through informal negotiations.³⁵

IV. DISCUSSION

13. *Beehive's Proposed Local Switching Rate.* In this Memorandum Opinion and Order, we will determine the reasonableness of Beehive's premium and non-premium interstate local switching rates from August 6, 1997 through December 31, 1997. In Transmittal No. 6, Beehive's local switching rates purportedly reflect a dramatic increase in Beehive's plant specific expenses and corporate operations

²⁶ Beehive Rebuttal at 7.

²⁷ *Id.* at 8.

²⁸ Beehive December 17 Supplement, Attachment at 1; Beehive Rebuttal at 8.

²⁹ Beehive Rebuttal at 9.

³⁰ *Id.* at 9.

³¹ *Id.*

³² *Id.* at 10.

³³ *Id.* at 11.

³⁴ *Id.* at 12.

³⁵ *Id.* at 13.

expenses.³⁶ Beehive claims that interstate plant specific expenses increased from \$176,543 in 1994 to \$974,190 in 1995 and \$839,727 in 1996. In addition, Beehive claims that interstate corporate operations expense increased from \$319,415 in 1994 to \$1,136,450 in 1995 and \$835,494 in 1996. Moreover, Beehive's reported interstate rate of return for local switching increased from 12.2% in 1994 to 111% in 1995 and 65% in 1996.³⁷

14. In the *Beehive Designation Order*, the Bureau directed Beehive to provide an explanation and cost data supporting any changes in costs and demand for 1994, 1995, and 1996.³⁸ Beehive, however, has failed to furnish an adequate explanation for its reported sharp increases in operating costs in 1995 and 1996. Beehive asserts that the increases in its expenses were primarily attributable to the purchase of fiber optic cable and to the cost of additional switching equipment needed to handle the increased interstate usage.³⁹ We would expect a significant increase in plant-specific expense, however, only if there is a commensurate increase in plant investment. Yet, the record reveals only a relatively small increase in plant investment by Beehive between 1994 and 1996.⁴⁰ Similarly, we would expect a dramatic increase in corporate operations expense only if the size of Beehive's business operations increased. The record does not show, however, a significant increase in its business operations. Beehive has also failed to explain the methodology that it used to calculate its reported increases in plant-specific expenses or corporate operating expenses. Beehive, for example, has failed to explain in detail or to quantify the cost of the fiber optic cable that it assertedly installed in 1995 and 1996. Similarly, it has not explained the basis for the expenses that it claims it incurred to stimulate interstate usage, nor has it demonstrated that such expenses are reasonably related to regulated local switching service.

15. In the *Rate of Return Represcription Order*, the Commission prescribed for interstate access services of all cost-of-service incumbent LECs an overall rate of return on investment of 11.25%.⁴¹ This rate of return prescription is applicable to small, as well as large, cost-of-service incumbent LECs.⁴² While carriers may obtain relief from the unitary rate of return prescription by filing an appropriate petition, under Section 65.102 of the Commission's rules, Beehive has not done so.⁴³ Indeed, Beehive acknowledges that its interstate access rates in Transmittal No. 6 reflected an excessive rate of return

³⁶ Plant specific expenses and corporate operations expenses account for three-fourths of Beehive's claimed interstate total operating expenses.

³⁷ See *Beehive Direct Case*, Attachment at 3, 6, 10.

³⁸ See *Beehive Designation Order* at para. 7.

³⁹ *Beehive Rebuttal* at 8-9.

⁴⁰ *Id.* at Exhibit 2.

⁴¹ *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, 5 FCC Rcd 7507 (1990) (*Rate of Return Represcription Order*), *recon.*, 6 FCC Rcd 7193 (1991), *affirmed*, *Illinois Bell Telephone Co. v. FCC*, 988 F.2d 1254 (D.C. Cir. 1993).

⁴² *Rate of Return Represcription Order*, 2 FCC Rcd at 3813.

⁴³ 47 C.F.R. § 65.102.

without further explanation other than that this result was inadvertent.⁴⁴

16. Under Section 201(b) of the Act, carriers have the burden of demonstrating that rates subject to investigation are just and reasonable.⁴⁵ Given Beehive's failure to justify or support its proposed increase in operating expenses and its use of an unauthorized rate of return in calculating the interstate local switching rates contained in Transmittal No. 6, we find that Beehive's rates subject to this investigation are unjust and unreasonable. We will therefore prescribe a rate, pursuant to Section 205(a) of the Act,⁴⁶ for the period subject to this investigation for the purpose of calculating refund liability between August 6, 1997 and December 31, 1997.

17. *Rate Prescription for Local Switching.* In order to determine reasonable local switching operating costs for Beehive, we have compared Beehive's operating expenses to the operating expenses of other LECs that serve a comparable number of access lines. Because Beehive has approximately 900 access lines, we compared Beehive's operating expenses to the operating expenses of LECs in the NECA pool with 800 to 1000 lines in 1995 or 1996. We used unseparated data filed with NECA⁴⁷ by companies with 800 to 1,000 lines to develop an average ratio of operating expenses to gross investment.⁴⁸ There were 31 such companies in 1995 and 24 in 1996. Absent unusual circumstances, which Beehive has not shown in this record, we would expect Beehive to have a substantially similar ratio of operating expenses to gross investment as other LECs that have a similar operating size. We also note that only eight of the 55 LECs in this sample reported larger plant investment than Beehive.

18. We compared the average total operating expense to total plant in service (TPIS) ratio for the companies in the sample to Beehive's ratio of total operating expense to TPIS, as reported in NECA Study data for 1995 and 1996. The mean (average) total operating expense to TPIS ratio for the 55 companies in the sample is 21.55%. By contrast, the data upon which Beehive computed the local switching rates contained in Transmittal No. 6 show a ratio of operating expense to TPIS of 59.96%. In 1994 and 1995, however, Beehive reports only slightly higher than average ratios of total operating expense to TPIS. In 1994, the ratio was 23.55% and in 1995 the ratio was 24.03%. In order to allow for the possibility that Beehive is a higher than average cost carrier, we will use an expense to TPIS ratio of 25% for our prescription. We believe this ratio will produce a reasonable estimate of Beehive's allowable operating expenses because three-fourths of the carriers in the sample of 55 experienced a lower ratio than 25%, and this ratio of 25% is higher than the ratio that Beehive reported to NECA for either 1994 or 1995. Accordingly, we disallow Beehive's operating expenses to the extent that such expenses exceed 25% of Beehive's TPIS.

⁴⁴ Beehive Rebuttal at 13. Moreover, the data Beehive submitted with its direct case indicates that Beehive's rate of return was 12.2% in 1994 and 115% in 1995. See Beehive Direct Case at 3, 6.

⁴⁵ 47 U.S.C. § 201(b).

⁴⁶ 47 U.S.C. § 205(a).

⁴⁷ See Universal Service Fund (USF) 1997 Submission of 1996 Study Results by the National Exchange Carrier Association, Inc., October 1, 1997; Universal Service Fund (USF) 1996 Submission of 1995 Study Results by the National Exchange Carrier Association, Inc., October 1, 1996; Universal Service Fund (USF) 1995 Submission of 1994 Study Results by the National Exchange Carrier Association, Inc., October 1, 1995.

⁴⁸ These data do not include Customer Operations Services expenses. We therefore add those expenses separately in our prescription calculations in the Appendix to this Memorandum Opinion and Order.

19. We find that prescribing rates that are based in part on industry's average costs, as we do in this Order, is consistent with our authority under Section 205(a) of the Communications Act. Section 205(a) provides in pertinent part that, whenever "after full opportunity for hearing, . . . the Commission shall be of opinion that any charge . . . of any carrier or carriers is or will be in violation of any of the provisions of this Act, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge."⁴⁹ Courts have consistently found in the Act a Congressional intent to grant us broad discretion in "selecting methods . . . to make and oversee rates."⁵⁰ In doing so, we may make any "reasonable selection from the available alternatives."⁵¹ Rather than insisting upon a single regulatory method for determining whether rates are just and reasonable, courts and other federal agencies with rate authority similar to our own evaluate whether an established regulatory scheme produces rates that fall within a "zone of reasonableness."⁵² For rates to fall within the zone of reasonableness, the agency rate order must undertake a "reasonable balancing" of the "investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates."⁵³

20. Our discretionary authority to prescribe rates based on the cost-averaging methodology described below is directly supported by the Supreme Court's decision in the *Permian Basin Area Rate Cases*.⁵⁴ In that decision, the Court upheld the Federal Power Commission's (FPC) decision to depart from its former practice of determining the reasonableness of natural gas producers' rates by examining the costs of each company on a case-by-case basis.⁵⁵ The Court found that the FPC's decision to prescribe maximum area rates for interstate natural gas sales based on composite cost data obtained from published sources and from producers through a series of cost questionnaires, fell within the "zone of

⁴⁹ 47 U.S.C. § 205(a).

⁵⁰ *MCI Telecommunications Corp. v. FCC*, 675 F.2d 408, 413 (D.C. Cir. 1982) (quoting *Aeronautical Radio v. FCC*, 642 F.2d 1221, 1228 (D.C. Cir. 1980), cert. denied, 451 U.S. 920 (1981)). See also *Western Union Int'l v. FCC*, 804 F.2d 1280, 1292 (D.C. Cir. 1986) ("The FCC's judgment about the best regulatory tools to employ in a particular situation is . . . entitled to considerable deference from the generalist judiciary."); MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241, 259 (1983) ("[A] prescribed rate is just and reasonable for purposes of Section 205(a) if it represents the best approximation of a rate that satisfies all statutory requirements that this Commission is capable of devising within a reasonable period of time.").

⁵¹ *MCI Telecommunications*, 675 F.2d at 413.

⁵² See, e.g., *FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979); *AT&T v. FCC*, 836 F.2d 1386, 1390 (D.C. Cir. 1988) (quoting *Jersey Cent. Power & Light v. FERC*, 810 F.2d 1168, 1177 (D.C. Cir. 1987)). See also *Wisconsin v. FPC*, 373 U.S. 294, 309 (1963); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942).

⁵³ *Jersey Cent. Power & Light*, 810 F.2d at 1177-78. See *Pennzoil Producing*, 439 U.S. at 517 (to fall within the zone of reasonableness, rates must be neither "less than compensatory" nor "excessive.").

⁵⁴ 390 U.S. 747 (1968).

⁵⁵ *Id.* at 768-70.

reasonableness" required by the Natural Gas Act.⁵⁶ The Court emphasized that the Natural Gas Act had conferred upon the FPC broad responsibilities to regulate interstate distribution of natural gas and that prescribing rates based on composite industry data was a valid exercise of the FPC's discretionary authority under the Act:

[T]he "legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself." It follows that rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, "to make the pragmatic adjustments which may be called for by particular circumstances."^{57]}

21. In light of our broad discretion to select appropriate regulatory tools for ratemaking purposes, we have, on other occasions, made rate prescriptions based on costs determined in part by an industry-wide average or mean. Our decision in this investigation to make rate prescriptions on the basis of an industry average is consistent, for example, with the methodologies we used to (1) establish a unitary rate of return for LECs' interstate access services,⁵⁸ (2) create a productivity factor for price cap LECs,⁵⁹ and (3) determine the reasonableness of depreciation rates for price cap LECs.⁶⁰

22. Further, we will use an 11.25% rate of return on Beehive's average, net interstate

⁵⁶ *Id.* at 768-74. The Court noted that Congress had entrusted the regulation of the natural gas industry to the "informed judgment of the Commission," and stated that "a presumption of validity therefore attaches to each exercise of the Commission's expertise." *Id.* at 767.

⁵⁷ *Id.* at 776-77 (citations omitted). The Court cited as precedent *Los Angeles Gas Co. v. Railroad Comm'n*, 289 U.S. 287, 304 (1933); *San Diego Land & Town Co. v. Jasper*, 189 U.S. 439, 446 (1903); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 474, 586 (1942).

⁵⁸ *Rate of Return Represcription Order*, 5 FCC Rcd at 7507-508. In prescribing the LECs' rate of return in the rate of return represcription proceeding, we (1) determined the cost of debt by calculating the average embedded cost of debt among the seven regional holding companies (RHCs) and (2) established the LECs' capital structure by determining the average embedded capital structure of the RHCs. Furthermore, the discounted cash flow method that we used to calculate the cost of equity established a single estimate of that cost for the entire LEC industry. *Id.* at 7508.

⁵⁹ Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, Appendix C (1990). The price cap scheme adopted in this Order adjusts the maximum prices that LECs may charge for their interstate services using a productivity factor ("X-Factor") that is based on data measuring the industry-wide average performance of the LECs. The validity of this methodology was reaffirmed in our Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, 10 FCC Rcd 8961, 9027 (1995).

⁶⁰ Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order, 8 FCC Rcd 8025, 8050 (1993). In determining whether a LEC's depreciation rates are presumptively reasonable, three factors are considered: the projected life of plant, the future net salvage value of plant, and a survivor curve. *Id.* at 8030. The Commission uses an industry average to develop ranges for two of the three factors, the projected life of plant and future net salvage value. *Id.* at 8050. These ranges are based on intervals of one standard deviation around the industry-wide mean value of the projected life of plant and future net salvage of plant underlying existing depreciation rates. *Id.*

investment, in prescribing a rate for local switching. In making this adjustment, we will recalculate the amount of federal income taxes that such rates must recover. The tax adjustment is necessary because a lower rate of return results in a lower corporate income tax liability.

23. Under Section 69.113 of the Commission's rules,⁶¹ Beehive's premium local switching rates are determined by dividing Beehive's local switching revenue requirement by demand.⁶² Demand is calculated by multiplying the number of non-premium, interstate DEM times 0.45 and adding to this sum the number of premium, interstate DEM. For this purpose, we are using a total DEM of 59,484,566, as reported in Beehive's supplemental direct case, filed on December 17, 1997.⁶³ Beehive reported its total DEM in its supplemental direct case in response to the *Beehive Designation Order's* requirement that Beehive file this information in its direct case.⁶⁴ In its rebuttal, filed 12 days later, Beehive revised its total interstate DEM to 55,585,564.⁶⁵ Although Beehive states that this change is "based on interstate access minutes of use as revised by Beehive in the course of the arbitration before the Utah Division of Public Utilities, Utah Department of Commerce," Beehive fails to provide any documentation to support this revision or explain why the DEM reported in its supplemental direct case differs from the DEM reported in its rebuttal.⁶⁶ We will therefore use the total DEM of 59,484,466, as reported in its supplemental direct case because that figure was subject to review and comment during the investigation.

24. In its supplemental direct case, Beehive did not disaggregate its total DEM into premium and non-premium DEM, as required by Section 69.113 of the Commission's rules. This information was provided in Beehive's rebuttal. We will use the ratio of premium and non-premium local switching minutes reported in Beehive's rebuttal for the sole purpose of determining the proportion of premium and non-premium DEM from Beehive's total DEM of 59,484,566. The data supplied in Beehive's rebuttal show that premium DEM is 56.50% and non-premium DEM is 43.50% of its total DEM.⁶⁷ Accordingly, we will apply these percentages to the total DEM of 59,484,566, as reported in Beehive's supplemental direct case, for the purpose of calculating Beehive's premium and non-premium rates.

25. We prescribe for Beehive a premium local switching rate of \$0.009443 per minute of use and a non-premium local switching rate of \$0.004249.⁶⁸ We are prescribing rates for both premium and

⁶¹ 47 C.F.R. § 69.113.

⁶² Non-premium local switching rates are determined by multiplying the prescribed premium local switching rates times 0.45. See 47 C.F.R. § 69.113.

⁶³ Beehive December 17 Supplement, Attachment at 1.

⁶⁴ See *Beehive Designation Order* at paras. 6-7.

⁶⁵ Beehive Rebuttal, Attachment at 1.

⁶⁶ We also note that Beehive's DEM increased dramatically between 1994 and 1996. Beehive's interstate DEM was 3,563,857 in 1994, 25,465,362 in 1995 and 30,120,102 in 1996. See Beehive December 17 Supplement, Attachment at 1; Beehive Rebuttal at 8.

⁶⁷ See *id.*, Appendix, Rate Development Worksheet at 1.

⁶⁸ See Appendix.

non-premium local switching because both rates in Transmittal No. 6 reflect Beehive's unjustified operating expenses and its unauthorized rate of return. In light of Beehive's historic demand, these rates will permit Beehive to recover its expenses and earn a reasonable return on its investments based on our analysis of operating expenses of similar size companies.

26. We reject Beehive's arguments that it should not be subject to refund liability for its high rate of return on the grounds that it "was not cognizant of its high interstate returns," that it was neither negligent nor acting in bad faith, and that, in its view, ratepayers suffered little harm.⁶⁹ Incumbent LEC customers are entitled to pay just and reasonable rates for interstate services under Section 201(b) of the Communications Act and these arguments do not justify Beehive's rates, which were up to four times higher than the rates we prescribe in this Memorandum Opinion and Order during the period under investigation. Accordingly, we will also require Beehive to calculate and refund to its customers the difference between the actual local switching revenues they obtained between August 6, 1997 and December 31, 1997 for the premium and non-premium local switching rate elements contained in Transmittal No. 6 and the local switching revenues that they would have obtained during this period based on rates prescribed above.

V. CONCLUSION AND ORDERING CLAUSES

27. For the reasons stated herein, **WE FIND** that the local switching rates, subject to this investigation and identified in this Order, of Beehive Telephone Company, Inc. and Beehive Telephone, Inc., Nevada are unlawful.

28. Accordingly, **IT IS FURTHER ORDERED** that pursuant to Sections 4(i), 201(b), 203, 204(a), and 205(a) of the Communications Act, 47 U.S.C. §§ 4(i), 201(b), 203, 204(a), 205(a), Beehive Telephone Company, Inc. and Beehive Telephone, Inc. Nevada **SHALL REFUND** to its access customers with compounded daily interest, the difference between the actual local switching revenues they obtained between August 6, 1997 and December 31, 1997 for each rate element and the local switching revenues that they would have obtained during this period based on rates prescribed in this Order. Interest shall be computed on the basis of interest specified by the United States Internal Revenue Service.

29. **IT IS FURTHER ORDERED** that Beehive Telephone Company must submit its plans for issuing refunds to the Common Carrier Bureau for review and approval pursuant to our delegation of authority under Section 0.291 of the Commission's rules, 47 C.F.R. § 0.291, within 30 days of the release of this Order.

⁶⁹ Beehive Rebuttal at 9.

30. **IT IS FURTHER ORDERED** that pursuant to Section 204(a) of the Communications Act, 47 U.S.C. § 204(a), the investigation instituted by the Common Carrier Bureau in CC Docket No. 97-237 for Beehive Telephone Company, Inc. and Beehive Telephone, Inc. Nevada, Transmittal No. 6 **IS TERMINATED.**

FEDERAL COMMUNICATIONS COMMISSION



Magalie Roman Salas
Secretary

Appendix: Calculation of Prescribed Local Switching Rates

In order to calculate prescribed local switching rates, we first developed a local switching revenue requirement and then divided this revenue requirement by access minutes demand, pursuant to Section 69.113 of the Commission's rules.

Table 1 shows the development of Beehive's local switching revenue requirement, based on the ARMIS data submitted by Beehive in its Direct Case. Beehive filed under Section 61.39 of the Commission's rules, which provides that rates shall be based on the historic costs and demand for the total period since the carrier's last annual filing. Because Beehive's last annual filing was in 1995, Beehive's 1997 annual access tariff reflects costs and demand for a 24 month period (1995 and 1996).

As discussed in this Memorandum Opinion and Order, we found that Beehive failed to support its operating expense data and we base our prescription on total operating expenses estimated at 25 percent of Total Plant in Service (TPIS). We calculate total operating expense for the 24 month period as \$2,819,404 by multiplying Line 1 (TPIS, from Line 1690, Col. B, of the ARMIS data submitted by Beehive in its Direct Case) by Line 2 (the ratio of total operating expense to TPIS selected in the Order). We then apply an interstate allocation factor of 0.4926, based on the sum of 1995 and 1996 interstate TPIS (ARMIS Line 1690, Column H) divided by the sum of 1995 and 1996 total company TPIS (ARMIS Line 1690, Column B). The result is Line 5, the interstate allocation of total operating expenses: \$1,388,891.

Lines 6-12 of Table 1 develop the return on investment portion of the interstate revenue requirement. Line 6 is average interstate net investment for 1995 and 1996 (ARMIS Line 1910, Col. H). We multiply Line 6 by Line 7 to calculate Line 8, the authorized interstate return on investment for each year. The total authorized interstate return for the two years is \$387,901 (Line 8). We subtract interstate fixed charges (Line 9, from ARMIS Line 1510, Col. H) to calculate Line 10, Interstate Return Subject to Federal Tax, \$366,259. Line 11 is the Federal tax gross-up of \$188,678, based on a federal tax rate of 34 percent. Line 12 adds the interstate portion of other taxes (ARMIS Line 1490, Col. H). Because the NECA data we used to examine operating costs of similar LECs excluded Customer Operations Services expenses, we add those expenses as reported by Beehive (ARMIS Line 1150, Col H).

The total interstate revenue requirement (Line 14) is the sum of Lines 5, 8, 11, 12 and 13. The total revenue requirement for 24 months is \$2,148,808.

We calculate the interstate local switching revenue requirement by multiplying Line 14 by Line 15, which is the switching share of interstate average net investment. This is calculated from ARMIS Line 1690, by dividing Col. N by Col. H. The result is Line 16, the 24 month switching revenue requirement of \$427,344.

Table 1: Development of Local Switching Revenue Requirement for Beehive Telephone Company*

Line	(a)	1995 (b)	1996 (c)	Combined (d)
1	Total Plant in Service (Ln. 1690, Col. B)	\$5,211,611	\$6,066,006	\$11,277,617
2	Prescribed Operating Expense to Investment Ratio			0.2500
3	Calculated Operating Expenses (Ln. 2 * Ln. 1)			\$2,819,404
4	Interstate Allocation Factor (Ln. 1690, Col. H / Col. B)			0.4926
5	Interstate Operating Expenses (Ln. 3 * Ln. 4)			\$1,388,891
6	Interstate Average Net Investment (Ln. 1910, Col H.)	\$1,670,514	\$1,777,494	n/a
7	FCC Authorized Rate of Return	0.1125	0.1125	
8	Authorized Interstate Return on Investment (Ln. 7 * Ln. 6)	\$187,933	\$199,968	\$387,901
9	Interstate Fixed Charges (Ln. 1510, Col H)	\$9,866	\$11,776	\$21,642
10	Interstate Return Subject to Federal Income Tax (Ln. 8 - Ln. 9)			\$366,259
11	Federal Income Tax @ 34% (Ln. 10 * 0.51515)			\$188,678
12	Interstate Total Other Taxes (Ln. 1490, Col. H)	\$40,090	\$29,776	\$69,866
13	Interstate Customer Operations Services (Ln. 1150, Col H)	\$35,168	\$78,304	\$113,472
14	Interstate Revenue Requirement (Lns. 5+8+11+12+13)			\$2,148,808
15	Ratio of Switching Net Investment to Interstate Net Investment (Ln. 1690, Col. N / Col. H)			0.1989
16	Switching Expense Allowed (Switching Revenue Requirement) (Ln. 15 * Ln. 14)			\$427,344

* Source: Beehive Telephone Company 1994 through 1996 Cost and Revenue Data, filed in its Direct Case on December 15, 1997, in CC Docket 97-237.

For ratios in Lines 4 and 15, column (d) is the sum of the 1995 and 1996 numerators divided by the sum of the 1995 and 1996 denominators.

**Table 2: Development of Local Switching Rates
for Beehive Telephone Company***

		1995	1996	Combined
1	Switching Revenue Requirement (Table 1, Ln. 16)			\$427,344
2	Total Interstate DEM minutes (Beehive, Supplement to Direct Case)	27,251,973	32,232,593	59,484,566
3	Percent Non-Premium (derived from Beehive Cost Support Filed Dec. 29, 1997)			43.50%
4	Premium Minutes (Ln. 2 * (1 - Ln. 3))			33,610,661
5	Non-Premium Minutes (Ln. 2 * Ln. 3)			25,873,905
6	Ratemaking Demand (Ln. 4 + 0.45 * Ln. 5)			45,253,919
	Prescribed local switching rates:			
7	Premium (Ln. 1 / Ln. 6)			\$ 0.009443
8	Non-Premium (Ln. 7 * 0.45)			\$ 0.004249

Table 2 shows the development of premium and non-premium local switching rates. Line 1 is the local switching revenue requirement that was calculated in Table 1. Line 2 contains total interstate DEM minutes, as submitted by Beehive in its "Supplement to Direct Case," filed December 17, 1997. Line 3 is the percent of non-premium access minutes, calculated from data submitted by Beehive with its Rebuttal on December 29, 1997 on a form entitled "Traffic Sensitive Rate Development Revision Effective July 1, 1997." We do not use the access minutes reported on that form, because Beehive does not explain why they differ from previously filed minutes, but this is the only data in the record presenting a breakdown of premium and non-premium minutes. We estimate total premium minutes by multiplying Line 2 by 1 minus Line 3. We estimate non-premium minutes by multiplying Line 2 by Line 3.

Section 69.113 of the Commission's rules requires demand for rate-making purposes be calculated by multiplying non-premium minutes by 0.45 and added to premium minutes. Line 6 performs this calculation to obtain rate-making demand. The premium local switching rate, Line 7, is equal to the revenue requirement (Line 1) divided by ratemaking demand (Line 6). The non-premium rate (Line 8) is calculated as 45 percent of the premium rate.